Supreme Court, U.S.
FILED
MAR 29 2005
OFFICE OF THE CLERK

No. 04-1056

IN THE

Supreme Court of the United States

EMC MORTGAGE CORPORATION,

Petitioner,

v.

STANLEY WILLIAM STARK; PATRICIA GARNET STARK,

Respondents.

On Petition for a Writ Of Certiorari to the United States Court Of Appeals for the Eighth Circuit

REPLY BRIEF FOR PETITIONER

THEODORE B. OLSON
Counsel of Record
DAVID DEBOLD
GIBSON, DUNN & CRUTCHER LLP
1050 CONNECTICUT AVENUE, NW
WASHINGTON, D.C. 20036-5306
(202) 955-8500

THEODORE J. BOUTROUS, JR.
JULIAN W. POON
GIBSON, DUNN & CRUTCHER LLP
333 SOUTH GRAND AVENUE
LOS ANGELES, CA 90071-3197
(213) 229-7000

Counsel for Petitioner
EMC Mortgage Corporation

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

I. The Unforeseeable Reading Of State Law Relied Upon By The Eighth Circuit To Reinstate The Arbitral Award of Punitive Damages In This Case Deprived Petitioner Of The "Fair Notice" To Which It Was Constitutionally Entitled, Under This Court's Recent Decision In *State Farm v. Campbell* 2

II. This Court Should Grant Review To Clarify The Threshold For Judicial Scrutiny And Invalidation Of Arbitral Awards Of Punitive Damages That Flatly Violate This Court's Due Process Guideposts 5

CONCLUSION 10

TABLE OF AUTHORITIES

Pages

CASES

Alack v. Vic Tanny International of Missouri, Inc.,
923 S.W.2d 330 (Mo. 1996) 3

BMW of North America v. Gore,
517 U.S. 559 (1996) 1, 5, 6, 8

Cooter & Gell v. Hartmarx Corp.,
496 U.S. 384 (1990) 8

First Options of Chicago, Inc. v. Kaplan,
514 U.S. 938 (1995) 6

Gannon v. Circuit City Stores, Inc.,
262 F.3d 677 (8th Cir. 2001) 1, 3, 4

George Watts & Son, Inc. v. Tiffany and Co.,
248 F.3d 577 (7th Cir. 2001) 6, 10

Gilmer v. Interstate/Johnson Lane Corp.,
500 U.S. 20 (1991) 6

Koon v. United States,
518 U.S. 81 (1996) 8

Mastrobuono v. Shearson Lehman Hutton,
514 U.S. 52 (1995) 4

Schoch v. InfoUSA, Inc.,
341 F.3d 785 (8th Cir. 2003) 6, 7

Shelley v. Kraemer,
334 U.S. 1 (1948) 7

State Farm v. Campbell,
538 U.S. 408, 416 (2003) ..... passim

Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1989) 5

Wilko v. Swan, 346 U.S. 427 (1953) 6

OTHER AUTHORITIES

Dan Schechter, *Arbitrator's $6 Million Punitive Damage Award Against Lender Is Upheld, Despite 3000-to-1 Ratio; Punitive Damage Waiver Invalid Under State Law*, COMM. FIN. NEWSLETTER, Sept. 13, 2004 10

Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577 (1997) 8

REPLY BRIEF FOR PETITIONER

Petitioner EMC Mortgage Corporation ("EMC") respectfully files this reply to the brief in opposition filed by Respondents.[1] Respondents do not directly address the question whether the Eighth Circuit's decision deprived EMC of the "fair notice" to which it was constitutionally entitled when the court used an unforeseeable reading of state law to overturn the parties' express agreement that punitive damages could not be awarded by the arbitrator. Nor do Respondents squarely grapple with or defend the Eighth Circuit's enforcement of a 3000:1 punitive damages award that is invalid on its face under *BMW of North America v. Gore*, 517 U.S. 559 (1996), and its progeny. Yet it is these errors in the decision below that could well prove to be the "poison pill that will lead many companies to stop including arbitration provisions in their contracts," thereby thwarting the strong federal policy favoring arbitration. *See* Brief of Amici Curiae Chamber of Commerce of the United States, the American Financial Services Association, the Consumer Mortgage Coalition, and the Financial Services Roundtable's Housing Policy Council ("Chamber Brief") at 3-4.

Instead of addressing the issues set forth in the petition, Respondents mischaracterize the first question presented as raising nothing more than an intra-circuit split on a minor question of local or state law. The Eighth Circuit's statement in *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 681-82 (8th Cir. 2001), that "Missouri courts have not suggested that

---

[1] EMC is hereby filing, concurrently with this Reply Brief, an express waiver of its right to file a Brief in Opposition to the conditional cross-petition for a writ of certiorari filed by Respondents and Cross-Petitioners in Docket No. 04-1184 (*Stark v. EMC Mortgage Corporation*). That conditional cross-petition asks this Court to engage in fact-bound error correction of the Eighth Circuit's unpublished and summary order rejecting Respondents' contention that they are entitled to 9% prejudgment interest under Missouri law.

it is improper for parties to include . . . terms [limiting the availability of punitive damages] in their [arbitration] contracts," *id.*, is certainly relevant to the first question raised by EMC in its Petition. But the relevance does not lie in the fact that *Gannon* is part of an intra-circuit conflict. Rather, *Gannon* merely confirms that the Eighth Circuit used an unprecedented and unforeseeable reading of state law to deprive the parties of fair notice of the enforceability of their own arbitration agreement.

Respondents also make no real attempt to defend the merits of the Eighth Circuit's tenuous and elliptical one-paragraph analysis of the proportionality and sheer magnitude of the 3000:1, $6 million punitive damage award in this case. Tellingly, Respondents simply rehash the view espoused by some courts that arbitral awards of punitive damages—even wildly disproportionate awards confirmed and enforced by federal or state courts—are immune from judicial scrutiny because no state action is supposedly involved or because the parties purportedly waived their due process rights by entering into arbitration. Yet by doing so, Respondents have only underscored the division and confusion amongst the lower courts regarding the proper measure of scrutiny courts should apply to arbitral awards of punitive damages that, on their face, never could have been awarded in the first instance by courts. *See* Petition at 23-26 (citing cases). Respondents have, in other words, only highlighted the need for immediate guidance and review by this Court.

I. The Unforeseeable Reading Of State Law Relied Upon By The Eighth Circuit To Reinstate The Arbitral Award of Punitive Damages In This Case Deprived Petitioner Of The "Fair Notice" To Which It Was Constitutionally Entitled, Under This Court's Recent Decision In *State Farm v. Campbell*.

Respondents never come to terms with the central point underlying the first question presented in EMC's Petition: namely that, prior to the Eighth Circuit's deeply flawed deci-

sion in this case, there was not even a hint of notice to parties negotiating an arbitration agreement that the applicable law prohibited them not only from waiving their *liability* for entire claims or causes of action sounding in tort, but also from limiting or waiving particular *forms of relief* that might be available under such claims. Instead of directly addressing this critical point, Respondents mischaracterize the first question presented, omit any reference to the "fair notice" principle on which it is based, and attempt to ascribe to EMC the "straw man" argument that review should be granted because of an intra-circuit split on a question of local or state law between the Eighth Circuit's decision in this case and its decision three years earlier in *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677 (8th Cir. 2001).

1. The following statement in *Gannon* conflicts with the central premise of the Eighth Circuit's decision in this case: "Missouri courts have not suggested that it is improper for parties to include . . . terms [limiting the availability of punitive damages] in their [arbitration] contracts." 262 F.3d at 681-82. In characterizing this statement as non-binding dicta, Respondents miss its significance, for *Gannon* simply confirms what was already the case—that EMC could not possibly have been on fair notice of the supposed Missouri-law prohibition on bargained-for limitations on particular forms of relief.[2] None of the cases or authorities cited by the Eighth Circuit or by Respondents, including the Missouri Supreme Court's decision in *Alack v. Vic Tanny International of Missouri, Inc.*, 923 S.W.2d 330 (Mo. 1996), suggest

---

[2] Respondents also suggest that *Gannon* is distinguishable because it "does not distinguish punitive damages for intentional torts and for negligence," whereas in the instant case "[t]he Eighth Circuit" supposedly "held that EMC and the Starks limited the punitive-damages waiver in this case to negligent torts." Opp. at 18 (citing Pet. App. 14a). However, there is no support, either on the page cited by Respondents or anywhere else in the Eighth Circuit's opinion, for the proposition that the Eighth Circuit "held that EMC and the Starks limited the punitive-damages waiver in this case to negligent torts."

otherwise. All of them deal with the separate and very different question of whether parties may waive their *liability* for entire "claims" or causes of action sounding in tort. *Id.* at 337-38. *See* Petition at 12-15 (also noting that courts have "recognize[d] that there are differences between a contract which insulates a party from liability and one which merely places a limit upon that liability").[3]

Consequently, EMC was deprived of the "fair notice" to which it was constitutionally entitled "'not only of the conduct that will subject [it] to punishment, but also of the severity of the penalty that a State may impose.'" *State Farm v. Campbell*, 538 U.S. 408, 416-17 (2003) (quoting *Gore*, 517 U.S. at 564). One of the "alternative bases" offered by Respondents in support of the Eighth Circuit's decision in this case—the Eighth Circuit's alternative holding that even if the arbitration agreement was ambiguous as to the awardability of punitive damages, the arbitrator's resolution of that ambiguity was not clearly irrational—is therefore inextricably intertwined with the first question presented in EMC's Petition. After all, the rationality of the arbitrator's resolution of this supposed ambiguity obviously turns on the tenability and foreseeability of the Eighth Circuit's unprecedented reading of Missouri law, of which the parties could not have been on fair notice when they entered into the arbitration agreement in this case.

2. As the amici have noted, even apart from the fair-notice principle grounded in the Due Process Clause, the novel and unprecedented reading of state law sprung upon EMC by the Eighth Circuit and the arbitrator in this case should be deemed preempted by the Federal Arbitration Act (FAA). If parties are unable to bargain for, establish, and

---

[3] Respondents also argue that *Gannon* has subsequently been limited to questions of "arbitrability," Opp. at 16-17. As for this supposed limitation, nothing more need be said than that this Court in *Mastrobuono v. Shearson Lehman Hutton, Inc.* treated the awardability of punitive damages by an arbitrator as a question of "arbitrability" to be resolved by the court. 514 U.S. 52, 58 (1995).

rely with certainty upon "the rules under which . . . arbitration will be conducted," and with fair notice of any state-law rules (supposed or actual) that might trump such freely bargained-for contractual rules, then it will become more "difficult for parties to enter into arbitration agreements," contrary to the strong federal policy in favor of arbitration. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989) (citation omitted); Chamber Brief at 7, cited *supra*.

II. This Court Should Grant Review To Clarify The Threshold For Judicial Scrutiny And Invalidation Of Arbitral Awards Of Punitive Damages That Flatly Violate This Court's Due Process Guideposts.

1. Respondents make little, if any, real attempt to defend, on its merits, the Eighth Circuit's elliptical and erroneous one-paragraph affirmance of the proportionality of the 3000:1, $6 million punitive damages award in this case, under the due process standards enunciated by this Court in *BMW v. Gore* and *State Farm*. *See, e.g.*, Opp. at 15 (reiterating the Eighth Circuit's flawed reliance on EMC's supposed net worth as a justification for the award, even though wealth "bear[s] no relation to the award's reasonableness or proportionality to the harm," and simply "'provides an open-ended basis for inflating awards when the defendant is wealthy,'" *State Farm*, 538 U.S. at 427-28 (citations omitted)).[4]

Rather than defend the constitutionality of the order enforcing the award, Respondents reiterate the position taken by some courts that there should be no judicial scrutiny of arbitral awards of punitive damages—even when courts confirm and enforce such awards, and when such awards could

---

[4] Respondents contend that the Petition misstates the amount of actual damages awarded as $1,000. *See* Opp. at 11. In fact, the Petition correctly notes that a total of $2,000 was awarded in actual damages, making the ratio of punitive damages to actual damages 3000:1. *See* Petition at 6.

never have been made by courts in the first instance. Respondents also speculate that requiring courts to confirm and enforce arbitral awards that are subject to no or minimalist judicial scrutiny will somehow advance the federal policy favoring arbitration. *See* Opp. at 22-25. In doing so, however, Respondents only underscore the need for immediate review by this Court to clarify the measure of scrutiny courts should apply to arbitral awards of punitive damages that, on their face, could not pass constitutional muster under *BMW* and *State Farm* had they been imposed by the court itself in the first instance.

2. Reprising the no-state-action or voluntary-waiver-of-due-process-rights approaches taken by some courts that refuse to scrutinize at all the arbitral awards that they confirm and enforce simply highlights the confusion and division amongst the lower courts as to the proper measure of judicial scrutiny (if any) to apply to arbitral awards of punitive damages. *See* Petition at 23-26 (citing cases); *see also George Watts & Son, Inc. v. Tiffany and Co.*, 248 F.3d 577, 580 (7th Cir. 2001) (Easterbrook, J.) (referring to the "conflicting lines of precedent" regarding the "'manifest disregard of the law'" standard of scrutiny, and noting that "[t]he law in other circuits is similarly confused, doubtless because the Supreme Court has been opaque");[5] *cf. also* Chamber Brief at 12-13 (discussing the confusion and disarray amongst lower courts with respect to "a number of" other "recent lower-court cases that have had the effect of substantially reducing the attractiveness of arbitration on the basis of at-best arguable interpretations of state law").[6]

---

[5] "The dictum in *Wilko [v. Swan*, 346 U.S. 427 (1953)] and *First Options [of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995)] was unexplained and unilluminated by any concrete application. Dictum in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 n. 4 (1991), is similarly unhelpful." *George Watts & Son, Inc.*, 248 F.3d at 580.

[6] Respondents suggest that this Court's recent denial of certiorari in *Schoch v. InfoUSA, Inc.*, 341 F.3d 785 (8th Cir. 2003), *cert.*

Most courts, including the Eighth Circuit in this case, have declined to adopt the extreme no-scrutiny position advocated by Respondents. *See id.* (citing cases). To suggest, as Respondents do, that courts confirming and enforcing arbitral awards of punitive damages should not scrutinize them at all—because such awards supposedly do not involve any state action—is to ignore the critical role courts and other governmental actors play in that confirmation and *enforcement* process. It is only through judicial enforcement, under a process created by statute, that arbitral awards of punitive damages have any consequence. *See, e.g.*, Chamber Brief at 11 ("It is the *confirming court itself* that is denying the respondent its right to due process by confirming an excessive award of punitive damages.") (citing *Shelley v. Kraemer*, 334 U.S. 1 (1948),[7] and Richard C. Reuben, *Public Justice: To-*

[Footnote continued from previous page]

denied, 540 U.S. 1180 (2004), warrants the same outcome here because of the supposed closeness of the question presented in *Schoch*: namely, whether "parties may contract in arbitration for more judicial review than the FAA provides." Opp. at 19 and n. 105. Even if one were to treat denials of certiorari as precedential, which they are not, and even if one were to treat that question as similar to the questions presented in this case, which it is not, Respondents' suggestion is bereft of merit for the simple reason that in *Schoch*, the question that Respondents claim was presented for this Court's review was not actually presented. *See* 341 F.3d at 789-90 (explaining that the court did not need to reach the question whether the parties could have validly contracted for de novo review by the district court of the arbitrator's ruling, "[b]ecause the parties did not 'clearly and unmistakably' express an intent to have the district court review de novo the arbitrator's award").

[7] As this Court explained in *Shelley v. Kraemer* in the analogous context of enforcement by *state* courts of the outcome of privately negotiated contractual arrangements: "That the action of state courts and of judicial officers in their official capacities is to be regarded as action of the State within the meaning of the Fourteenth Amendment, is a proposition which has long been established by decisions of this Court." 334 U.S. 1, 14 (1948) (citations omitted). Here, as in *Shelley*, "[i]t is clear that but for the active

ward a State Action Theory of Alternative Dispute Resolution, 85 CAL. L. REV. 577, 619-629 (1997)).[8]

Significantly, some courts, such as the Second and District of Columbia Circuits, have applied the "manifest disregard of the law" standard in a rigorous way with respect to arbitral resolutions of statutory rights. It therefore follows that such scrutiny should be applied to arbitral resolutions (here, denials, to be precise) of *constitutional* rights. Even if it does not, plain violations of the due process right to be free from arbitrary deprivations of property through constitutionally excessive awards of punitive damages should nonetheless be overturned under even the most deferential standard of review available to courts. *Cf. Koon v. United States*, 518 U.S. 81, 100 (1996) ("A district court by definition abuses its discretion when it makes an error of law.") (citing *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 406 (1990)).

3. Again, here, as even Respondents acknowledge, the sole basis for the award of punitive damages in this case was the posting of a sign in the front window of Respondents' vacant house stating as follows: "'Property has been secured and winterized. Not for sale or rent. In case of emergency

---

[Footnote continued from previous page]

intervention of the . . . courts, supported by the full panoply of state power," EMC would not actually be deprived of its property in an arbitrary and excessive manner, as it has been by the Eighth Circuit here. *Id.* at 19.

[8] Respondents' suggestion that EMC waived its challenge, under *BMW* and *State Farm*, to the excessiveness of the 3000:1 punitive damage award in this case is meritless. EMC clearly and vigorously argued the excessiveness, under the Due Process Clause, of the arbitral award of punitive damages in this case when this issue first arose—*i.e.*, when courts were called upon to confirm and enforce the award. *See, e.g.*, Appellants' Appendix ("AA") 269-271 (district court); Appellee's Brief at 52-55 (court of appeals); Appellee's Petition for Rehearing at 9-13. In any event, EMC also argued to the arbitrator the requirement of proportionality even before the arbitrator imposed any punitive damages award. *See, e.g.*, AA 563-64; Appellee's Appendix at 394.

call 1st American (732) 363-3626.'" *See* Petition at 3, 19 (quoting Pet. App. 3a); *see also* Opp. at 6 (stating that punitive damages were awarded under the state-law claim for intentional infliction of emotional distress, and not the FDCPA). Respondents do not dispute that this sign-posting occurred only once, nor do they dispute that the sign-posting did not "evinc[e] an indifference to or a reckless disregard of the health or safety of others." *State Farm*, 538 U.S. at 419 (citation omitted). Under the first prong of *State Farm*'s proportionality analysis then, the "degree of reprehensibility" of EMC's conduct leading to the punitive-damage award was minimal, at best. *See* Petition at 20-21 (explaining why the 3000:1, $6 million punitive-damage award in this case would be invalid on its face under the three-prong excessiveness analysis set forth by *State Farm*).

4. Given that arbitral awards of punitive damages can occasionally depart as markedly as the award did here from the range that any court could permissibly impose in the first instance, it is difficult to credit Respondents' speculation that cutting off judicial review of the excessiveness of arbitral awards of punitive damages would promote the strong federal policy favoring arbitration. *See* Opp. at 24-25 (contending that greater "expedition, simplicity, and reduced costs" would result from requiring courts to rubber-stamp the magnitude of arbitral awards when courts confirm and enforce such awards).

It seems far more likely that this supposed benefit from non-existent review would be outweighed by the *ex ante* chilling effect of entering into arbitration agreements without any meaningful protection from outlier awards of punitive damages. *See, e.g.*, Chamber Brief at 9-10 (given that empirical studies do "not support the hypothesis that juries award larger punitive [damage] awards than arbitrators" do, "contracting parties may well decide that the risk of a massive punitive [damage] award being assessed against them outweighs the possible benefits of arbitration," "if an arbitrator's award of punitive damages is subject to no review (or to only extremely limited review) by a confirming court"); Dan

Schechter, *Arbitrator's $6 Million Punitive Damage Award Against Lender Is Upheld, Despite 3000-to-1 Ratio; Punitive Damage Waiver Invalid Under State Law*, COMM. FIN. NEWSLETTER, Sept. 13, 2004, at 64 (predicting that the Eighth Circuit's decision in this case will not "withstand scrutiny," but cautioning businesses to "think twice about arbitration agreements," and suggesting that "[i]t might be better to draft a really good jury waiver and then have the case tried to a judge, subject to all of the usual rules of evidence and due process"); *cf. George Watts & Son, Inc. v. Tiffany and Co.*, 248 F.3d 577, 584 (7th Cir. 2001) (Williams, J., concurring in the judgment) ("when the arbitrator acts in manifest disregard of statutory law, there is no compelling reason that we should not intervene and protect the statutory rights of the parties—otherwise the parties would be better off flipping a coin").

In any event, whether Respondents' no-scrutiny position or the meaningful scrutiny advocated by EMC would best advance the strong federal policy favoring arbitration is a question on the merits that should be resolved by this Court.

CONCLUSION

The Court should grant the petition for a writ of certiorari.

Respectfully submitted.

THEODORE B. OLSON
Counsel of Record
DAVID DEBOLD
GIBSON, DUNN & CRUTCHER LLP
1050 CONNECTICUT AVENUE, NW
WASHINGTON, D.C. 20036-5306
(202) 955-8500

THEODORE J. BOUTROUS, JR.
JULIAN W. POON
GIBSON, DUNN & CRUTCHER LLP
333 SOUTH GRAND AVENUE
LOS ANGELES, CA 90071-3197
(213) 229-7000

Counsel for Petitioner
EMC Mortgage Corporation

March 29, 2005